

## **STRUCTURAL REFORMS TO RAISE THE RP SAVING RATE**

**Victor A. Abola and Emilio Neri, Jr.**

As a follow-up to a previous study on the lagging saving rate in the Philippines and the role of financial institutions in this phenomenon, the authors try to determine if the Asian currency crisis has provoked a banking crisis in the Philippines and its impact on the saving rate. Using the definitions of banking crisis as used by Caprio and Klingebiel (1996), and Demirguc-Kunt and Detragiache (1998), the authors estimate the relevant measures for the Philippines and come to the conclusion that there is no banking crisis there. Looking further into the coming years, the authors make use of logit analysis and regression analysis to conclude that it is unlikely for a banking crisis to develop. However, because the banking system has been weakened, there is still the medium-term need to clean up the system and strengthen it in order for it to efficiently perform its role in sustaining long-term growth. Correspondingly, there has been no movement of savings out of banks, although there are threats to holding and improving the saving rate.

In the second part of the study, the authors look into the banking reforms carried out or proposed to be effected, in order to determine their sufficiency in strengthening the banking system and public confidence in it. The reforms were analyzed in terms of how they improve the informational and incentive relationships (1) between banks and the providers of funds, (2) between banks and the users of funds, and (3) between banks and the supervisory regime that governs them. For the first, the existence of deposit insurance at a low limit may provide a safeguard for market failure for that segment of less-informed depositors. There is no desire for the present institution to increase the coverage, but rather to give it more access to information and improve the legal and juridical framework and capability to expedite receivership and liquidation processes.

Regarding the relationship between banks and providers of funds, it was noted that government involvement or cronyism was practically nil. What stood out as problematic were connected lending and excessive risk-taking. Limits on connected lending had long been in place, but needs better supervision and disclosures. Excessive risk-taking may be minimized with the high capital adequacy ratio attained by local banks, and increased minimum capital requirements required since 1996. However, the authors feel that competition from foreign banks could better safeguard against heightened connected lending that higher capitalization could foster.

Where the authors find greater weakness was in the legal and judicial framework, particularly in failure resolution, receivership-liquidation process, accounting, and disclosure standards, and in sufficiently punitive and effective sanctions for violations. While loss classification and provision has been tightened considerably, improvement in the other areas mentioned mostly require legislation, and thus, may take some time to effect. On the balance, however, the reforms put in place should positively contribute to the strengthening of the banking system and the confidence of the savers up to the medium-term.